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CONTRACT COMPLIANCE AUDIT  
NEW DIRECTIONS



## PRELIMINARY AUDIT REPORT

Prepared by:  
California Department of Corrections and Rehabilitation  
Office of Audits and Compliance

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November 2008

### CONTRACT NUMBERS P04.0025 and P04.1011

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**OFFICE OF AUDITS AND COMPLIANCE**

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## AUDITOR'S REPORT

Dale Benner, Executive Director  
New Directions  
1981 Cherokee Road  
Stockton, CA 95205

Dear Mr. Benner:

The California Department of Corrections and Rehabilitation's (CDCR) Office of Audits and Compliance (OAC), Audits Branch completed a fiscal contract compliance audit of contract numbers P04.0025 and P04.1011 between Alcohol and Drug Awareness Program (New Directions) and CDCR.

Under the terms of the contract, the contractor agreed to provide a co-ed facility for housing, substance abuse and independent living skills for at-risk parolees in order to transition them back into the community. The costs for these services were not to exceed the contract amounts of \$528,685 (P04.0025) and \$385,368 (P04.1011).

The audit was conducted in accordance with generally accepted governmental auditing standards, including tests of controls and other such auditing procedures considered necessary under the circumstances.

The scope of the audit was limited to financial and selected compliance activities for the contract period of July 1, 2005 through June 30, 2006. The audit fieldwork was conducted from June 11, 2007 to July 20, 2007.

The specific objectives of the audit were to determine if:

- Expenses claimed were for actual program costs, supported by appropriate source documentation, and consistent with the CDCR's Line Item Budget Guide's (LIBG) cost principles.
- New Directions complied with the fiscal terms and conditions of contract numbers P04.0025 and P04.1011.

The procedures performed in the audit included:

- A review of the contracts' fiscal provisions and related accounting and program records, as well as pertinent laws, rules, and regulations.

- Testing of financial transactions to provide reasonable assurance that the contractor complied with the contractor's fiscal provisions, in addition to other tests of payment propriety as deemed necessary by the Audits Branch.

The Audits Branch identified five fiscal findings in relation to salaries, benefits, operating costs, indirect costs, and profit fee. Because the audit was limited to selected test periods and fiscal transactions, OAC does not express an opinion on the contractor's internal controls or contract compliance as a whole for contract numbers P04.0025 and P04.1011.

RICHARD C. KRUPP, Ph.D.  
Assistant Secretary  
Office of Audits and Compliance

July 20, 2007 (last date of fieldwork)

## EXECUTIVE SUMMARY

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The CDCR contracted with New Directions to operate a Residential Multi-Service Center (RMSC) in Stockton, California. A RMSC is a CDCR program that provides homeless parolees with shelter, sustenance, and life skills to transition them back as productive members of society. Under contract number P04.0025, CDCR contracted with New Directions for \$1,767,172 for the term of April 1, 2005 through June 30, 2008. Under contract number P04.1101, CDCR contracted with New Directions for \$1,564,861 for the term of January 1, 2005 through December 31, 2008.

The Audits Branch audited New Directions' RMSC transactions for the period of July 1, 2005 through June 30, 2006. During the audit period, CDCR paid New Directions \$908,934 for both contracts.

The Audits Branch identified five findings with total questioned costs of \$129,297. The questioned costs are summarized below and are discussed in more detail in the Findings and Recommendations section of the report.

There are funds available in the budgets of the two contracts to eliminate all but \$456 of the total questioned costs of \$129,297. This can be accomplished through the Budget Transfer Request (BTR) process. A BTR is an informal document used by the contractor to indicate budget transfer costs of existing contract funds without the need to process a formal amendment. The BTR can only be used when there is no increase in the funding level or no change in the scope of the contract. The BTR enables the contractor within certain parameters to adjust the line item budget to reflect actual expenditures.

### Summary of Questioned Costs

Findings	Items	Contract No. P04.0025	Contract No. P04.1011	Total
1	Salaries	\$ 7,288	\$48,770	\$ 56,058
2	Benefits	1,458	9,754	11,212
3	Rent	16,166	8,276	24,442
4	Operating Expenses	17,004	6,660	23,664
5	Indirect and Profit/Service	5,105	8,816	13,921
<b>TOTAL</b>		<b>\$47,021</b>	<b>\$82,276</b>	<b>\$129,297</b>

## SUMMARY OF FINDINGS

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### **FINDING 1: Salaries**

The CDCR overpaid New Directions \$56,058 in staff salaries for the two contracts. New Directions was overpaid \$48,770 for contract number P04.1011 and \$7,288 for contract number P04.0025. The overpayment was due to salaries exceeding actual costs and salaries exceeding their budget.

### **FINDING 2: Benefits**

The contract allows the contractor to charge CDCR 20 percent of their direct salaries for fringe benefits. Unallowable fringe benefits are a result of unallowable staff salaries. The total overpayment was \$11,212 (disallowed salaries of \$56,058 x 20 percent).

### **FINDING 3: Rent**

CDCR reimbursed New Directions for monthly mortgage principal payments. The LIBG only allows the contractor to be reimbursed for their mortgage interest and depreciation. The total overpayment was \$24,442.

### **FINDING 4: Operating Expenses**

The contractor was overpaid \$23,664 for operating expenses. The overpayment is a combination of billings exceeding budgeted amounts and unallowable costs based upon LIBG criteria.

### **FINDING 5: Indirect Costs and Profit/Service Fee**

Unallowed indirect costs and profit/service fee are simply a percentage applied against the disallowed direct costs with the four findings above. The total overpayment was \$13,921.

## BACKGROUND

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### **Contract P04.0025**

Under the terms and provisions of contract number P04.0025, New Directions is to provide a 30 bed RMSC in Stockton, California for participating parolees. Housing, substance abuse services, and independent living skills are provided to at-risk parolees in order to transition them back into the community.

The RMSC is a co-ed facility licensed by the California Department of Alcohol and Drug Programs. Participants are monitored on a twenty-four hour/seven days a week basis and the contractor's security system's designed to prevent illicit drug use and unauthorized entry or exit from the facility. Participants can stay up to 180 days in the program, which includes five phases of treatment, beginning from intake through aftercare. Some participants may stay up to one year with prior written approval.

Initially, the contract was bid as a "per diem" type of reimbursement. The contract was later changed to a "cost reimbursement" contract.

### **Contract P04.1011**

Contract number P04.1011 is in the same Stockton facility as contract number P04.0025. The contract provides for 19 co-ed beds and is a per diem contract subject to the terms and conditions of the LIBG.

The average length of stay in the program is 180 days. The program provides residential substance abuse services in order to facilitate a parolee's abstinence from substance abuse, and must be provided in accordance with the State's accepted medical practice and regulations governing narcotic/alcohol maintenance.



## FINDINGS AND RECOMMENDATIONS

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### **FINDING 1: Salaries**

New Directions was reimbursed for more than actual salary costs, resulting in an overpayment of \$56,058. The table below summarizes the amounts by position.

<b>Position</b>	<b>P04.0025</b>	<b>P04.1011</b>	<b>Combined Total</b>
Facility Manager/Program Dir.	\$ 56	\$ 141	\$ 197
Counseling Supervisor/Facility Dir.	1,462	1,022	2,484
Case Workers/Monitors	768	25,029	25,797
Counselor	(364)	21,895	21,531
Administration Assistant	1,500	563	2,063
Cook	2,449		2,449
Receptionist	1,417	120	1,537
<b>Total Overpayments</b>	<b>\$7,288</b>	<b>\$48,770</b>	<b>\$56,058</b>

The over billed salaries is the result of one or both of the following reasons:

1. New Directions billed for salaries exceeding actual costs.
2. New Directions billed for salaries exceeding their budgeted allotment.

### **Criteria:**

The October 2002 LIBG, page 2 of 20, states: "Salaries of personnel who are providing services for more than one contract must be charged to each contract on a proportional basis and are only allowable for the time the employee is assigned to this contract."

The October 2002 LIBG, page 2 of 20, states in part: "Actual costs incurred by the contractor which are allowable costs shall be substantiated with appropriate source documentation . . . ."

### **Recommendation:**

New Directions should bill CDCR each month for the actual salaries incurred by job classification, not to exceed the monthly budget. New Directions should prepare a BTR for CDCR's approval, in order to reduce or eliminate the \$56,058 overpayment.

### **FINDING 2: Benefits**

The CDCR overpaid New Directions \$11,212 in fringe benefits. The overpayment of fringe benefits is a direct result of overpaid salaries in Finding 1. The contract limited allowable fringe benefits to 20 percent of actual salaries. The following table summarizes the overpayment.

<b>Contract</b>	<b>Overpayment of Salaries</b>	<b>Fringe Benefit Rate</b>	<b>Overpayment of Fringe Benefits</b>
P04.0025	\$ 7,288	20%	\$ 1,458
P04.1011	48,771	20%	9,754
<b>Total Unallowable</b>	<b>\$56,059</b>	<b>20%</b>	<b>\$11,212</b>

Fringe benefits consists of medical, dental, vision, supplemental medical, life insurance, workers compensation, State unemployment insurance, and social security/medicare (FICA).

**Criteria:**

The October 2002 LIBG, page 3 of 20, states in part: “. . . actual costs for staff benefits will be provided based on a percentage of total salaries. A CDC [currently CDCR] audit will be performed on actual cost.”

**Recommendations:**

New Directions should prepare a BTR for CDCR's approval, in order to reduce or eliminate the \$11,212 overpayment.

**FINDING 3: Rent**

LIBG guidelines were not followed when billing CDCR for depreciation and interest, resulting in an overpayment of \$24,442.

CDCR reimbursed New Directions for its monthly loan principal. The auditors calculated allowable depreciation and interest and offset the totals against the reimbursed principal.

The following table delineates the three components utilized to calculate the overpayment of \$24,442.

<b>By Contract</b>	<b>P04.0025</b>	<b>P04.1011</b>	<b>Total</b>
Reimbursed (principal)	\$35,100	\$20,800	\$55,900
Allowed Depreciation & Interest	\$18,934	\$12,524	\$31,458
Disallowed Depreciation & Interest	<b>\$16,166</b>	<b>\$ 8,276</b>	<b>\$24,442</b>

**Criteria:**

According to contract number P04.0025, page 17, “The Contractor's Facility Manager is responsible for preparing and administering an accounting manual, which maintains adequate fiscal records to determine allowable and applicable program costs in accordance with Generally Accepted Accounting Principles.”

Per the CDCR's LIBG, January 1997 (revised September 2000):

- Fiscal Audits, page 11 of 22, states in part: “Actual costs incurred by the Contractor for expenses should be substantiated with appropriate source documentation.”

- Fiscal Audits, page 11 of 22, states in part: **“Per Diem Rate Contractors Only:** The per diem rate is based on the Contractor’s attached budget projections of costs using approved line-item allocations. The State reserves the right to audit or review the Contractor’s financial records at any time to determine if expenditures incurred were allowable per the line item budget.”

The CDCR’s LIBG, October 2002 Revision:

- Operating cost, page 5 of 20, 3b, “If the contractor owns the facility, they may be compensated for the use of buildings through depreciation and current interest expense related to the purchase of the facility.”

#### **Recommendation:**

New Directions should prepare a BTR for CDCR’s approval, in order to reduce or eliminate the \$23,664 overpayment.

#### **FINDING 4: Operating Expenses**

##### **Unallowable Operating Costs (Exclusive of Rent)**

New Directions was overpaid \$23,664 for operating expenses (exclusive of rent); \$17,004 for contract number P04.0025 and \$6,600 for contract number P04.1011.

New Directions total audited operating expenses for all operations, which consisted of five cost centers, was \$382,359. The \$382,359 was allocated to the five cost centers. Rent was subtracted, which resulted in a total of \$331,074 in allowable operating expenses. Operating expenses of \$111,541 was allocated to contract P04.0025, and operating expenses of \$68,650 was allocated to contract P04.1011. (See table below.)

<b>Exp Adjustment</b>	<b>RMSC P04.0025</b>	<b>CDCR P04.1011</b>	<b>HUD/SASCA</b>	<b>Admin</b>	<b>Day Care/ Construction</b>	<b>Total</b>
Allowed	\$130,475	\$81,174	\$90,830	\$71,744	\$8,136	\$382,359
Less Rent	(18,934)	(12,524)	(13,067)	(3,257)	(3,503)	(51,285)
<b>Allowed</b>	<b>\$111,541</b>	<b>\$68,650</b>	<b>\$77,763</b>	<b>\$68,487</b>	<b>\$4,633</b>	<b>\$331,074</b>

The audited operating expenses of \$111,541 for P04.0025 and \$68,650 for P04.1011 are broken down by operating line item in the following table. Each expenditure was compared to what was paid, resulting in the over/(under) payment of each line item.

The over/(under) payments were a result of the difference between budgeted expenditures and expenditures billed. The amounts billed either were based on budget amounts or included unallowable expenses, such as capital expenditures, unrelated taxes, supplies, fund raising and interest expense, or was an expense for which no operating line items existed.

The summary of the findings for the two contracts are broken down in the following table:

**Contract P04.0025**

<b>Account</b>	<b>Audited</b>	<b>CDCR Paid</b>	<b>Over/(Under) Payment</b>
Client Transportation	\$ 5,662	\$ 5,009	\$ (653)
Maintenance/Repair	5,402	7,532	2,130
Communications	4,413	6,438	2,025
Utilities	19,323	24,395	5,072
Insurance	5,712	10,190	4,478
Supplies/Expend Equip	16,458	15,531	(927)
Non Expend Equip	0	0	0
House Hold	2,436	4,071	1,635
Food	44,412	46,857	2,445
Drug Testing	7,723	8,522	799
<b>Total</b>	<b>\$111,541</b>	<b>\$128,545</b>	<b>\$17,004</b>

**Contract P04.1011**

<b>Account</b>	<b>Audited</b>	<b>CDCR Paid</b>	<b>Over/(Under) Payment</b>
Client Transportation	\$ 3,744	\$ 6,840	\$ 3,096
Maintenance/Repair	3,572	5,150	1,578
Communications	2,918	4,320	1,402
Utilities	12,781	11,000	(1,781)
Insurance	3,778	6,000	2,222
Supplies	12,493	2,000	(10,493)
Non Expend Equip	0	0	0
House Hold	0	0	0
Food	29,364	40,000	10,636
Drug Testing	0	0	0
<b>Total</b>	<b>\$68,650</b>	<b>\$75,310</b>	<b>\$ 6,660</b>

**Total - Both Contracts**

**\$23,664**

**Criteria:**

Per contract number P04.0025, page 17, "The Contractor's Facility Manager is responsible for preparing and administering an accounting manual, which maintains adequate fiscal records to determine allowable and applicable program costs in accordance with Generally Accepted Accounting Principles."

Per the CDCR's LIBG, October 2002 Revision:

- Actual and Allowable Costs, page 2 of 20, states in part: "Actual costs incurred by the Contractor, which are allowable costs shall be substantiated with appropriate source documentation and applicable receipts, such as invoices and receipts for any cost contained in the budget proposal....Allowable costs for a contract shall be

limited to those expenditures which are: (1) in conformance with the approved contract budget and have specific prior approval when required; and (2) for goods and services necessary to the project's operation at the time the costs are incurred. Any expenses not meeting these criteria may be disallowed."

- Operating Costs, page 4 of 20, states in part: "Allowable operating costs are defined as necessary program expenditures, which are based on actual costs substantiated by source documentation. Operating costs can include expendable equipment costs but are exclusive of personal service costs, sub-contractor/consultant service costs and indirect costs...Only documented direct costs needed to provide services for this contract are allowable and should not be based on the overall organizational expenses.
- Non-Expendable Equipment, page 6 of 20, states in part: "**Depreciation Method:** Contractors **will be allowed** to be compensated for the use of non-expendable equipment through depreciation. The computation of depreciation shall be based on the acquisition cost and the useful life of the non-expendable equipment."
- Unallowable Costs, page 10 of 20, states in part: "**Capital Expenditures** – The construction, remodel, renovation, alteration, improvement or repair costs of privately-owned property which would enhance the value of such property to the benefit of the owner unless requested by the State."

#### **Recommendation:**

New Directions should prepare a BTR for CDCR's approval, in order to reduce or eliminate the \$23,664 overpayment.

#### **FINDING 5: Indirect Costs and Profit/Service Fee**

Unallowed indirect costs and profit/service fee are simply a percentage applied against the unallowed direct costs in Findings 1, 2, 3, and 4. The total overpayment is \$13,921. (See the following table)

<b>Indirect Cost</b>			
<b>Contracts</b>	<b>P04.0025</b>	<b>P04.1011</b>	<b>Total Combined</b>
Allowable Direct Costs	\$425,454	\$270,617	\$696,071
Indirect Rate	10%	10%	10%
Allowed Indirect Costs	42,545	27,062	69,607
Billed	46,740	34,408	81,148
Over Payment	<b>4,195</b>	<b>7,346</b>	<b>11,541</b>
<b>Profit/Service Fee</b>			
Allowable Direct Costs	425,454	270,617	696,071
Profit/Service Fee Rate	2%	2%	2%
Allowed	8,509	5,412	13,921
Billed	9,419	6,882	16,301
Over Payment	<b>910</b>	<b>1,470</b>	<b>2,380</b>
<b>Total Overpayment</b>	<b>\$ 5,105</b>	<b>\$ 8,816</b>	<b>\$ 13,921</b>

New Directions' actual indirect costs are higher than the 10 percent of direct cost allowed in the contract; however, reimbursement of indirect costs is limited to 10 percent of direct costs.

**Criteria:**

According to LIBG, revised September 2000, page 7 of 22, and revised October 2002, page 8 of 20, "Any unallowable costs from an audit may result in a recalculation of profit/service fee costs and recovery by CDC of the difference."

**Recommendation:**

New Directions should prepare a BTR for CDCR's approval, in order to reduce or eliminate the \$13,921 overpayment.

# GLOSSARY

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**BTR**.....Budget Transfer Request

**CDC**.....California Department of Corrections

**CDCR**.....California Department of Corrections and Rehabilitation

**LIBG**.....Line Item Budget Guide

**OAC**.....Office of Audits and Compliance

**RMSC**.....Residential Multi-Service Center